

KELLOGG, HUBER, HANSEN, TODD & EVANS, P.L.L.C.

MICHAEL K. KELLOGG
PETER W. HUBER
MARK C. HANSEN
K. CHRIS TODD
MARK L. EVANS
STEVEN F. BENZ
NEIL M. GORSUCH
GEOFFREY M. KLINEBERG
REID M. FIGEL

SUMNER SQUARE
1615 M STREET, N.W.
SUITE 400
WASHINGTON, D.C. 20036-3209
(202) 326-7900
FACSIMILE:
(202) 326-7999

HENK BRANDS
SEAN A. LEV
EVAN T. LEO
ANTONIA M. APPS
MICHAEL J. GUZMAN
AARON M. PANNER
DAVID E. ROSS
SILVIJA A. STRIKIS
RICHARD H. STERN, OF COUNSEL

May 16, 2001

VIA HAND DELIVERY

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
Room TW-B-204
445 12th Street, S.W.
Washington, D.C. 20554

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MAY 16 2001

**FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY**

Re: Application by SBC Communications Inc., Southwestern Bell Telephone Company, and Southwestern Bell Communications Services, Inc. d/b/a Southwestern Bell Long Distance for Provision of In-Region InterLATA Services in Missouri, CC Docket No. 01-88

Dear Ms. Salas:

Pursuant to the Commission's filing requirements for Bell company applications under section 271 of the Communications Act, the following are being provided with this letter:

- One original and four copies of Southwestern Bell's Reply in paper form, redacted for public inspection. The Reply includes a Reply Brief in support of the Application and a Reply Appendix containing supporting affidavits.
- One CD-ROM disc containing the Reply Brief and Reply Appendix, in electronic form, redacted for public inspection.
- One original in paper form of only those portions of the Reply that contain confidential information (in paper form). One copy of this letter will also accompany the confidential portions of the Application. Some of the material we are submitting includes confidential information. None of this information is disclosed to the public, and disclosure would cause substantial harm to the competitive position of

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Magalie Roman Salas

May 16, 2001

Page 2

Southwestern Bell. As such, we are requesting that these portions of the Reply receive confidential treatment by the Commission.

Please date-stamp the extra copies of this letter and return it to the individual delivering this package.

We are submitting a copy of the entire Reply, in paper form, redacted for public inspection, to ITS (the Commission's copy contractor). In addition, a total of 31 copies of the Reply Brief and 22 copies of Reply Appendix in paper form, and 22 CD-ROM versions of the entire Reply in electronic form, all redacted for public inspection, are being provided to the Common Carrier Bureau.

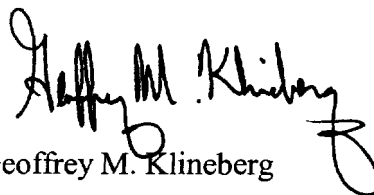
We are also submitting a copy of this cover letter and the confidential material to Gary Remondino, Policy and Program Planning Division, Common Carrier Bureau, Federal Communications Commission, Room 5-C-140, 455 12th Street, S.W., Washington, D.C. 20554. In addition, we are providing six copies of this cover letter and the confidential material to Layla Seirafi, U.S. Department of Justice, 1401 H Street, N.W., Suite 8110, Washington, D.C. 20005. Finally, we are providing the Department of Justice seven copies of the Reply Brief and Reply Appendix in paper form and seven CD-ROM versions of the entire Reply in electronic form, all redacted for public inspection.

All inquiries relating to access (subject to the terms of any applicable protective order) to any confidential information submitted by Southwestern Bell in support of this Application should be addressed to:

Kevin Walker
Kellogg, Huber, Hansen, Todd & Evans, P.L.L.C.
1615 M Street, N.W., Suite 400
Washington, DC 20036
(202) 367-7820 (direct)
(202) 326-7999 (fax)

Should you have any questions, please call me at (202) 326-7928. Thank you for your assistance in this matter.

Sincerely,



Geoffrey M. Klineberg

Encs.

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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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MAY 16 2001

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of

Application by SBC Communications Inc.,
Southwestern Bell Telephone Company, and
Southwestern Bell Communications Services,
Inc. d/b/a Southwestern Bell Long Distance for
Provision of In-Region, InterLATA Services in
Missouri

CC Docket No. 01-88

To: The Commission

**REPLY BRIEF OF SOUTHWESTERN BELL
IN SUPPORT OF INTERLATA RELIEF IN MISSOURI**

JAMES D. ELLIS
PAUL K. MANCINI
MARTIN E. GRAMBOW
KELLY M. MURRAY
ROBERT J. GRYZMALA
JOHN S. DI BENE
JOHN M. LAMBROS
175 E. Houston
San Antonio, Texas 78205
(210) 351-3410

Counsel for SBC Communications Inc.

PAUL G. LANE
One Bell Center, Room 3520
St. Louis, Missouri 63101
(314) 235-4300

*Counsel for Southwestern Bell
Telephone Company*

MICHAEL K. KELLOGG
GEOFFREY M. KLINEBERG
KELLOGG, HUBER, HANSEN,
TODD & EVANS, P.L.L.C.
1615 M Street, N.W., Suite 400
Washington, D.C. 20036
(202) 326-7900

*Counsel for SBC Communications Inc.,
Southwestern Bell Telephone
Company, and Southwestern Bell
Communications Services, Inc.*

ALFRED G. RICHTER, JR.
175 E. Houston, Room #1250
San Antonio, Texas 78205
(210) 351-3500

*Counsel for Southwestern Bell
Telephone Company*

May 16, 2001

REDACTED — FOR PUBLIC INSPECTION

EXECUTIVE SUMMARY

Over the past five years, the Missouri Public Service Commission ("Missouri PSC") has conducted weeks of contested hearings, resolved hundreds of disputed issues, and painstakingly established rates for SWBT wholesale services. It has now finally reached the conclusion that Southwestern Bell has satisfied all of the requirements to provide interLATA services in Missouri. The vast majority of commenters have also expressed their support, looking forward to the additional competition in the long-distance markets that Southwestern Bell's entry will bring. The evidence presented in this record overwhelmingly supports the granting of this Application. After reviewing the entire record, the Department of Justice ("DOJ") and the usual commenters have identified a few issues, none of which justifies denying this Application.

First, some have questioned whether there is sufficient evidence in the record to support a finding that the rates established for unbundled network elements in Missouri comply with this Commission's TELRIC rules. But the commenters are asking this Commission not only to second-guess the judgments of the Missouri PSC, reached after years of analysis, testimony, and cross-examination, but also to do what this Commission has expressly disavowed – conduct a de novo review of state pricing determinations in a section 271 proceeding. As this Commission well understands, TELRIC is a methodology to be applied by each state commission, not a formula that generates specific rates.

The evidence overwhelmingly demonstrates that the Missouri PSC adhered to TELRIC principles in establishing the rates. None of the specific factual findings criticized by the DOJ or the other commenters even constitutes an error in the application of the TELRIC methodology at all, let alone one on a matter so substantial that the end result falls outside the range that a reasonable application of TELRIC principles would produce. Moreover, as this Commission

reiterated recently in granting Verizon's section 271 application in Massachusetts, whether a particular CLEC has a sufficiently sound business plan to make a profit using particular cost-based wholesale rates is not a prerequisite for granting the application. Try as AT&T and others might to blame their business failures on the Missouri UNE rates, the truth is that the problems experienced by CLECs nationwide are either of their own making or linked to particular vulnerabilities in the recent economic downturn.

Second, some have raised questions about Southwestern Bell's compliance with its legal obligations regarding the provision of advanced telecommunications services. It is clear, however, that Southwestern Bell is satisfying all of its legal obligations to provide CLECs with access to the high frequency portion of a loop, even where that loop is served by a digital loop carrier. AT&T's argument on this issue amounts to nothing more than the demonstrably false claim that this Commission's orders currently require incumbent LECs to provide unbundled access to their packet switching functionality. This Commission is now investigating that very question; in the meantime, SWBT has no present obligation to unbundle those facilities.

The DOJ and others have also raised the issue of whether SBC is satisfying its obligations under section 251(c)(4) to offer for resale at a wholesale discount those advanced telecommunications services that its advanced services affiliate – SBC Advanced Solutions, Inc. (“ASI”) – is providing at retail to end-user subscribers who are not themselves telecommunications carriers. But, notwithstanding accusations to the contrary, ASI is a wholesale provider of DSL transport service to Internet service providers and a retail provider only to certain grandfathered services and specific contract service arrangements with large, business customers. Because ASI's DSL transport service is not a retail service provided directly to end-user subscribers – but is rather a wholesale service provided to ISPs, which then

bundle it together with their own Internet access to produce a retail service offered to end users – SBC has no obligation to offer ASI's DSL transport for resale at a wholesale discount.

Third, the commenters have raised a few issues relating to SWBT's operations support systems ("OSS"). In particular, two commenters have identified an issue with one of SWBT's maintenance and repair legacy systems used in the handling of electronic trouble reports for both retail POTS service and CLEC resale and UNE-P orders. There is no evidence at all that the issue in the database has caused any difficulties or delays in delivering maintenance and repair services to customers or in resolving trouble reports on a timely basis. In addition, SWBT has implemented a system enhancement that will ensure that this does not recur. Moreover, SWBT has now completed the process of correcting the status on the embedded base of incorrect records, ensuring that CLECs will be able to open trouble reports electronically for these UNE-P lines.

Some commenters have also expressed concern about the way electronic orders flow through SWBT's OSS. AT&T takes issue, for example, with the way SWBT has interpreted the business rule for calculating a particular performance measurement, yet both the Missouri PSC and Ernst & Young have concluded that SWBT's interpretation of the relevant business rule is reasonable. Moreover, even if AT&T's interpretation of the business rule were accepted, the impact on the relevant performance metric would be minimal. Other commenters suggest that SWBT's flow through rates for LEX in Missouri are inadequate, yet they compare favorably with those in states that have already received section 271 approval. And this Commission has already found evidence that SWBT's region-wide system has procedures in place to ensure the accuracy of manual processes.

In addition, commenters raise a variety of specific OSS issues, none of which has any merit. WorldCom reiterates its tired objections to the adequacy of third-party testing of the regional nature of SWBT's systems. Other commenters complain about certain performance data that is months old and ignore more recent, excellent performance results. Notwithstanding the fact that some CLECs are successfully ordering UNE-P service with the Metropolitan Calling Area option for their end users in the St. Louis metropolitan area, McLeodUSA claims to be unable to do so. However, McLeodUSA has been unwilling to provide SWBT with the necessary information to determine why their orders have been rejected. A few commenters have made vague and unsupported allegations concerning SWBT's billing accuracy and dispute resolution process, but this Commission rejected these commenters' nearly identical complaints in the Texas proceeding.

Various CLECs raise a number of miscellaneous issues, none of which conceivably justifies denying this Application:

Although no one seriously disputes that SWBT has satisfied its Track A showing in Missouri, AT&T and others have challenged Southwestern Bell's estimates of the extent of local competition. The evidence is clear, however, that the level of local competition in Missouri is comparable to the level in Texas at the same point in the regulatory process.

McLeodUSA raises a number of collocation and interconnection issues that have already been resolved by this Commission or by the Missouri PSC in proceedings recently completed. Even its complaints about trunk provisioning and performance are over six months old.

A number of commenters criticize SWBT's performance on provisioning unbundled loops. Yet SWBT's comprehensive performance data demonstrate that it provides nondiscriminatory access in the pre-ordering, ordering, and provisioning of xDSL-capable loops

and related services in Missouri. And, notwithstanding McLeodUSA's unsupported assertion, CLECs in Missouri have already begun to place a significant number of line sharing orders. There is also no merit to McLeodUSA's assertion that the M2A somehow precludes CLECs from engaging in line splitting. Although a few CLECs allege that SWBT has failed to provide parity in the provisioning of DS1 loops, they ignore SWBT's actual performance record.

McLeodUSA argues that SWBT has improperly refused to recognize CLECs as participants in the Missouri PSC's Metropolitan Calling Area ("MCA") Plan, thereby engaging in anticompetitive conduct inconsistent with the public interest. But McLeodUSA has grossly misrepresented the record with respect to the MCA issue, and it is seeking to relitigate issues it has already lost before the Missouri PSC.

SCC has alleged that SWBT provides discriminatory access to the 911 database in violation of this Commission's rules. But SCC is not operating as a CLEC in Missouri and has not pointed to any instance where SWBT has failed to comply with its obligations under checklist item 7. Because SCC is a provider of 911 database services to CLECs and not a CLEC itself, the M2A simply does not apply to its business. Contrary to SCC's assertions, SWBT permits CLECs to update their subscriber information more often than SWBT itself. In short, there is simply no merit to SCC's allegations.

A few commenters have challenged the sufficiency of SWBT's performance remedy plan. But this plan builds on the plans that this Commission approved in Texas, Kansas, and Oklahoma. AT&T also complains about the adequacy of Ernst & Young's audit of the performance measurements. But AT&T's complaint rests on its own misinterpretation of the relevant data.

* * * * *

None of the comments has called into question the wisdom of granting this Application. Southwestern Bell has demonstrated in this record that there are competing providers in Missouri that are offering service to residential and business subscribers predominantly over their own facilities pursuant to binding agreements that fully implement the fourteen-point competitive checklist. Moreover, Southwestern Bell has demonstrated not only that it will provide its long-distance service through a separate affiliate in accordance with section 272, but also that Southwestern Bell's provision of such services is in the public interest, convenience, and necessity. Having therefore satisfied the requirements of section 271 in Missouri, Southwestern Bell respectfully requests that this Commission grant the Application.

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REPLY APPENDIX

Affidavits

- Tab 1. Lincoln E. Brown and John S. Habeeb
(Operations of SBC's Separate Advanced Services Affiliate)
- Tab 2. Carol A. Chapman
(Advanced Services Offerings)
- Tab 3. Daniel J. Coleman, William R. Dysart, Elizabeth A. Ham, Brian D. Noland, David R. Smith, and Thomas E. Weisz
(Nondiscriminatory Access to SWBT's Loop Maintenance Operations System)
- Tab 4. William C. Deere
(911 and E911 Related Issues)
- Tab 5. William R. Dysart
(Performance Monitoring)
- Tab 6. Elizabeth A. Ham and Brian D. Noland
(Nondiscriminatory Access to OSS)
- Tab 7. Thomas F. Hughes
(Missouri Public Service Commission Proceedings)

- Tab 8. Michael Kelly
(Ernst & Young's Attestation)
- Tab 9. Alan G. Kern
(CLEC Review of SWBT's Missouri Cost Studies and Models)
- Tab 10. Tim J. Morrissey
(Cost and Pricing Issues)
- Tab 11. Philip G. Naughton
(Depreciation)
- Tab 12. Barbara A. Smith
(Cost Studies)
- Tab 13. Rebecca L. Sparks
(Checklist Items 1, 2, and 14)
- Tab 14. David R. Tebeau
(Local Competition and Track A Compliance)
- Tab 15. Bill E. VanDeBerghe
(Nondiscriminatory DS1 and DSL Provisioning)
- Tab 16. Linda G. Yohe
(Public Interest and Section 272 Forbearance)

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554**

In the Matter of

Application by SBC Communications Inc.,
Southwestern Bell Telephone Company, and
Southwestern Bell Communications Services,
Inc. d/b/a Southwestern Bell Long Distance for
Provision of In-Region, InterLATA Services in
Missouri

CC Docket No. 01-88

To: The Commission

**REPLY BRIEF OF SOUTHWESTERN BELL
IN SUPPORT OF INTERLATA RELIEF IN MISSOURI**

INTRODUCTION

The vast majority of comments filed in this proceeding support Southwestern Bell's Application for long-distance authority in Missouri. Most of these comments look forward to the benefits that Southwestern Bell's entry will bring to the long distance market. See, e.g., Fleishman Hillard Comments at 1 ("Allowing Southwestern Bell to provide long distance service will offer Missouri residents and businesses significant choices and better value for their telecommunications services, which was the intent of the 1996 Act."); Campaign for Telecommunications Access Comments at 22 ("allowing SBC to provide long-distance service in its universal service areas will both create incentives for SBC to maintain and invest in the vitality of the networks in those areas and cause SBC and the current long-distance competitors to lower prices in those areas."); Farmington Chamber of Commerce Comments at 1 ("The [1996 Act] was passed to provide more competition in the long distance market, holding prices down

and providing more efficient service to the long distance customer. We believe Southwestern Bell's entry into the long distance market will further benefit citizens and businesses in the area, falling directly in line with the goals of the Act.”).

Other comments recognize the benefits that granting this Application will bring to competition in local telecommunications markets. See, e.g., City of Hillsboro Comments at 1 (“Southwestern Bell's entry into the long distance market would spur competition for both local and long distance services and bring customers new opportunities for packages of services that meet their individual needs.”); Dillon Company Comments at 1 (“Southwestern Bell's entry into the long distance market will mean more choices, lower prices, and better service in both the long distance and local markets.”).

Furthermore, the Missouri PSC has unambiguously supported this Application: “Based on the extensive record in this case, the availability of the M2A to Missouri CLECs, and the Commission's intention to expeditiously determine permanent rates, terms, and conditions for collocation, line sharing, line splitting, loop conditioning, and unbundled network elements, . . . [the Missouri PSC] recommends that the FCC grant SWBT's Application for authorization to provide in-region, interLATA services in the state of Missouri.” Final Missouri PSC Order at 91;¹ see also Missouri PSC Written Consultation at 2 (indicating that the Missouri PSC “continues to support” the Application).

¹ Order Regarding Recommendation on 271 Application Pursuant to the Telecommunications Act of 1996 and Approving the Missouri Interconnection Agreement (M2A), Application of Southwestern Bell Telephone Co. to Provide Notice of Intent to File an Application for Authorization to Provide In-Region InterLATA Services Originating in Missouri Pursuant to Section 271 of the Telecommunications Act of 1996, Case No. TO-99-227 (Mo. PSC Mar. 15, 2001) (App. C, Tab 98).

Predictably, the incumbent interexchange carriers – AT&T, WorldCom, and Sprint – together with a small group of CLECs oppose this Application. These commenters have focused their attention on three principal issues: First, whether the unbundled network element (“UNE”) rates established by the Missouri PSC are consistent with this Commission’s TELRIC methodology; second, whether SWBT is providing nondiscriminatory access to certain of its operations support systems; and third, whether SWBT is complying with its legal obligations with respect to the provision of advanced telecommunications services. Southwestern Bell will address each of these issues and then briefly respond to a variety of miscellaneous matters that the commenters have raised.

DISCUSSION

I. PRICING OF UNBUNDLED NETWORK ELEMENTS

As SWBT demonstrated in its Application, the Missouri PSC established rates for unbundled network elements (“UNEs”) that are consistent with this Commission’s TELRIC methodology. See Southwestern Bell Br. at 27-37. Notwithstanding the extraordinary efforts that the Missouri PSC and its Staff undertook in setting cost-based rates over the course of several years, AT&T, WorldCom, and Sprint have identified the UNE rates as their principal area of concern with this Application.²

While it is true that some of the rates in Missouri are higher than comparable rates in Texas, Kansas, and Oklahoma, that fact alone cannot justify the conclusion that the Missouri PSC failed to set cost-based rates. Comparing one state’s rates to another state’s rates is problematic for many reasons, not the least of which is that it is inconsistent with the statutory

² DOJ has largely repeated the claims of AT&T, concluding that this Commission should conduct a de novo review of the rates established by the Missouri PSC. See DOJ Evaluation at 9-10.

design. Each separate state commission has the responsibility for determining “the just and reasonable rate for network elements . . . based on the cost . . . of providing the . . . network element.” 47 U.S.C. § 252(d)(1). There is no requirement that a state commission look to another state’s determination on a particular rate issue. The Missouri PSC was under no obligation to ensure that its rates were established within a particular Commission-prescribed percentage of Texas or Kansas rates.³ If this Commission mandates that Missouri rates be no more than a fixed percentage above Texas rates for every element, then this Commission will have set the Missouri rates, something which it has always professed to be beyond its authority. Indeed, such a claim would be legally unsupportable: “[T]he FCC does not have jurisdiction to set the actual prices for the state commissions to use. Setting specific prices goes beyond the FCC’s authority to design a pricing methodology and intrudes on the states’ right to set the actual rates pursuant to § 252(c)(2).” Iowa Utils. Bd. v. FCC, 219 F.3d 744, 757 (8th Cir. 2000). As Southwestern Bell argued in its opening brief, the Commission’s role in this 90-day, expedited proceeding is to review the “general methodologies” used by the Missouri PSC, not to second-guess the rates approved for use by the Missouri PSC. See Southwestern Bell Br. at 36.

Notwithstanding the fact that this Commission does not conduct a de novo review of rates in a section 271 proceeding, see Kansas/Oklahoma Order ¶ 59,⁴ several commenters and the DOJ

³ As Tim Morrissey discusses in his Reply Affidavit, the Commission’s Hybrid Cost Proxy Model (“HCPM”) was never intended to depict UNE costs. See Morrissey Reply Aff. ¶ 6; see also id. ¶ 8 (“Testing for compliance with TELRIC relying solely on state cost differences derived from the FCC HCPM Model – absent a state’s commission’s refusal to set rates or improper setting of rates – is too simple of a test and may fail to account for real variations in costs between states that may exist.”).

⁴ Memorandum Opinion and Order, Joint Application by SBC Communications Inc., et al., for Provision of In-Region, InterLATA Services in Kansas and Oklahoma, CC Docket No. 00-217, FCC 01-29 (rel. Jan. 22, 2001).

have insisted that the Commission do just that. Yet, this Commission must resist the invitation to revisit each rate decision identified by some commenters and reweigh every piece of evidence presented to the Missouri PSC. Nevertheless, in this reply brief and the accompanying affidavits, Southwestern Bell rebuts each and every argument that the Missouri PSC failed to apply TELRIC when arbitrating the permanent rates in Case No. TO-97-40.

Before turning to the specific complaints about particular rate elements, Southwestern Bell will briefly respond to the entirely unfounded accusation that SWBT has somehow improperly prevented CLECs from gaining access to its cost models and inputs. See WorldCom Comments at 5; AT&T Comments at 15 n.6; DOJ Evaluation at 14 n.47. Southwestern Bell has provided precisely the same cost information as part of its Application for section 271 relief in Missouri as it provided in Texas, Kansas, and Oklahoma. See B. Smith Reply Aff. ¶ 7. Southwestern Bell has never previously provided cost studies in electronic form as part of its section 271 application, nor has anyone ever asked it to do so.⁵

Furthermore, no CLEC ever complained about access to electronic versions of SWBT cost studies before the Missouri PSC. See B. Smith Reply Aff. ¶ 8. And this is not surprising,

⁵ Indeed, notwithstanding WorldCom's misrepresentations to the contrary, see WorldCom Comments at 5 & n.4, prior to the filing of this Application, counsel for WorldCom never requested access to the UNE cost models and data in electronic form. See Letter from Jerome L. Epstein, Jenner & Block, to Geoffrey M. Klineberg, Kellogg, Huber, Hansen, Todd & Evans, P.L.L.C. (Mar. 26, 2001), reprinted at Tab B of WorldCom's comments. The request for access to the electronic versions of these models came only after the Application was filed. After investigating the availability of the 1997 LPVST cost study, the 1997 ACES model, and the 1997 CAPCOST study, counsel for SBC explained to WorldCom's counsel that these old studies were simply no longer available in electronic form. Nevertheless, on April 23, 2001, in an effort to accommodate the request and a similar one from the Commission's Competitive Pricing Division, SBC provided a CD-ROM containing the inputs used for the UNE Loop Cost Study; the CAPCS model, populated with the Missouri capital cost inputs; and the ACES spreadsheets, modified into Excel format. See Letter from Geoffrey M. Klineberg, Kellogg, Huber, Hansen, Todd & Evans, P.L.L.C., to Magalie Roman Salas, Secretary, FCC, CC Docket No. 01-88 (FCC filed Apr. 23, 2001).

given that both WorldCom and AT&T had been active participants in the cost portion of the Texas Mega-Arbitration, where the exact same cost models were being used. Id. ¶ 9. As part of the Texas Mega-Arbitration, the Texas Commission required SWBT to provide CLECs with training and access to SWBT's cost models. During the week of January 27, 1997, SWBT held a five-day training course in Austin, Texas to train CLEC personnel on the SWBT models and SWBT cost studies. CLECs had access to electronic and paper versions of every SWBT cost study. During this week-long training course, 19 people from AT&T and MCI/WorldCom attended. After the workshop in Texas, mini workshops were held in February and March 1997. See id. As part of the Texas Mega-Arbitration, CLECs deposed almost 100 subject matter experts, who had provided inputs to the SWBT cost studies. It is simply untrue, therefore, that AT&T and WorldCom did not have access to these cost studies.

In Missouri, SWBT made its cost studies and voluminous supporting documentation available in September and October 1996 to representatives of both AT&T and MCI/WorldCom. See Kern Reply Aff. ¶ 4. The traditional nondisclosure agreement was revised to allow employees of AT&T and MCI/WorldCom access to the cost studies, and those studies were sent to Austin, Texas to allow AT&T and MCI/WorldCom greater access. See B. Smith Reply Aff. ¶ 10. Several representatives from both companies reviewed the cost materials in Austin. See Kern Reply Aff. ¶ 5. In October 1996, throughout the hearings in Case No. TO-97-40, the cost studies and material were made available to both AT&T and MCI/WorldCom in Jefferson City. Id. ¶ 6. A number of AT&T and MCI/WorldCom representatives in fact reviewed the studies and supporting material during this period. Id. ¶ 7.

The complaints about access to SWBT's cost studies are a smokescreen. All of the cost models supporting the UNE rates were submitted with this Application in paper form. That is no

different from the way this cost evidence has always been submitted to this Commission in section 271 applications. Moreover, the electronic versions of these studies were all made available as part of the Texas Mega-Arbitration. Because SWBT's cost studies during this period were the same throughout its region, CLECs had access to them in any number of different cost proceedings.

A. The Missouri PSC Followed TELRIC in Setting UNE Rates

A few commenters and the DOJ have argued that the Missouri PSC failed to establish UNE rates using forward-looking cost principles consistent with this Commission's TELRIC methodology. But as Barbara Smith details in her reply affidavit, each of their specific criticisms fails.

In arbitrating the rates as part of Case No. TO-97-40, the Missouri PSC thoroughly and carefully reviewed thousands of inputs that the parties proposed. It had to make difficult and controversial choices among proposals that often varied substantially from one another. Nevertheless, in every case identified by the commenters and the DOJ, the Missouri PSC applied a forward-looking methodology and set rates that were consistent with this Commission's TELRIC principles. The Missouri PSC did so notwithstanding the fact that the Commission's TELRIC methodology had been invalidated and was inapplicable at the time of the First Arbitration Order. Indeed, in reviewing the rates that were established in this docket, the District Court for the Western District of Missouri rejected this Commission's request that it remand the pricing issues to the Missouri PSC "to reconsider its pricing decisions in light of the TELRIC regulations," because, in the words of the District Court, "[t]he PSC did apply TELRIC

methodology when making its pricing decisions, so a remand on this ground would serve no purpose.”⁶

1. The UNE Rates Are Not Inflated

In their comments, AT&T and the DOJ assert that SWBT's UNE rates are improperly inflated by certain assumptions relating to depreciation rates, allocation of common costs, and power and engineering costs that all violate TELRIC principles. See AT&T Comments at 16-20; see also DOJ Evaluation at 16-18 (repeating AT&T's allegations). This is demonstrably false.

Depreciation. In the Local Competition Order,⁷ this Commission explained that “an appropriate calculation of TELRIC will include a depreciation rate that reflects the true changes in economic value of an asset and a cost of capital that appropriately reflects the risks incurred by an investor.” 11 FCC Rcd at 15856, ¶ 703. In a footnote, the Commission elaborated further that, “[p]roperly calculated,” economic depreciation “is a periodic reduction in the book value of an asset that makes the book value equal to its economic or market value.” Id. n.1711.

In establishing the UNE rates, the Missouri PSC clearly adopted a depreciation rate reflecting the true changes in economic value of SWBT's assets. In an exhaustive analysis of depreciation, the Missouri PSC Staff reasoned that, at least with respect to the kind of equipment used in the provision of local telephone service, “[e]conomic obsolescence has overtaken

⁶ AT&T Communications of the Southwest, Inc. v. Southwestern Bell Tel. Co., 86 F. Supp. 2d 932, 949 n.7 (W.D. Mo. 1999) (emphasis added), rev'd and vacated on other grounds sub nom. Southwestern Bell Tel. Co. v. Missouri Pub. Serv. Comm'n, 236 F.3d 922 (8th Cir. 2001).

⁷ First Report and Order, Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, 11 FCC Rcd 15499, modified on recon., 11 FCC Rcd 13042 (1996), vacated in part, Iowa Utils. Bd. v. FCC, 120 F.3d 753 (8th Cir. 1997), aff'd in part, rev'd in part sub nom. AT&T Corp. v. Iowa Utils. Bd., 525 U.S. 366 (1999), decision on remand, Iowa Utils. Bd. v. FCC, 219 F.3d 744 (8th Cir. 2000), petitions for cert. granted sub nom. Verizon Communications Inc. v. FCC, 121 S. Ct. 877 (2001).

physical deterioration as the primary cause of loss of value and retirements.” Final Arbitration Order, AT&T Communications of the Southwest, Inc.’s Petition for Arbitration Pursuant to Section 252(b) of the Telecommunications Act of 1996, Case No. TO-97-40, Attach. C, at 99 (MPSC July 31, 1997) (“Costing and Pricing Report”) (App. G, Tab 11). In other words, “[i]t is the competitive market demand for the newest features and functions that controls the economic life of telephone equipment, rather than the physical durability of that equipment, as was the case under rate of return regulation.” Naughton Reply Aff. ¶ 7.

The regulatory “prescribed rates” – the ones that AT&T argues should be used – are not appropriate because they are based on physical obsolescence, rather than on economic obsolescence. See id. ¶ 5. Moreover, the prescribed rates are not forward looking, and rely on equipment life ranges that were developed in the mid-1990s, based on even older data. Id. As the Missouri PSC Staff explained, “a reasonable assumption is that TELRIC telephone plant will probably not be able to be depreciated over as long a life as embedded plant.” Costing and Pricing Report at 101; id. at 105 (“one must take the perspective of an investor creating a network from scratch today”). So, contrary to the DOJ’s suggestion that there is something wrong with shorter asset lives, see DOJ Evaluation at 16, it is entirely reasonable to assume that, in a competitive environment, a “company’s depreciation life must be short enough to recover its investment from the pool of customers receiving benefit from that plant, or risk never recovering the investment fully.” Costing and Pricing Report at 100.⁸

⁸ There is nothing inconsistent in the way the maintenance expenses have been calculated and the use of shorter depreciation lives for plant. SWBT’s maintenance expenses are calculated based on a factor applied to forward looking investment, not to booked investment. Therefore, the maintenance expenses in SWBT’s cost studies are lower than the booked maintenance expenses, as one would expect for plant using shorter depreciation lives. See Costing and Pricing Report at 83-84.

The depreciation lives established by the Missouri PSC were based on SWBT's proposals as modified by the Missouri PSC Staff. As Barbara Smith explains in her reply affidavit, the depreciation lives are very close to the lives that AT&T itself uses in its own depreciation calculations for the same categories of plant. See B. Smith Reply Aff. ¶ 66. In its comments, AT&T neglects to mention this fact, even though the Missouri PSC Staff compared the two companies' depreciation rates and found that, with respect to the most significant investments, "[t]he numbers compare favorably." Costing and Pricing Report at 105. Just as this Commission rejected AT&T's challenge to the Oklahoma depreciation rates in the Kansas/Oklahoma Order (¶ 76), so should it do so here. As in the prior proceeding, this Commission should refuse to require state commissions to adopt this Commission's depreciation rates and reaffirm that "[a] state may find that a depreciation schedule such as the one proposed by SWBT is appropriate." Id.

Common Costs. In the Local Competition Order, this Commission recognized that, because common costs are incurred in the provision of network elements, "setting the price of each discrete network element based solely on the forward-looking incremental costs directly attributable to the production of individual elements will not recover the total forward-looking costs of operating the wholesale network." 11 FCC Rcd at 15852, ¶ 694. Moreover, this Commission explained that "[o]ne reasonable allocation method would be to allocate common costs using a fixed allocator, such as a percentage markup over the directly attributable forward-looking costs." Id. at 15853, ¶ 696.

SWBT developed its common cost allocator by dividing its total common costs by its total expenses, defined to include operating expenses, capital-related costs of return on capital, depreciation and income tax expenses, and excluding any common costs. See B. Smith Reply

Aff. ¶ 69. The resulting factor is applied to the forward-looking TELRIC cost of the UNE to provide the basis for the forward-looking UNE price. Id.

After reviewing SWBT's common cost allocator study, the Missouri PSC Staff had "no specific concerns or proposed modifications." Cost and Pricing Report at 125. Contrary to the suggestion in both AT&T's comments (at 18) and the DOJ Evaluation (at 17-18), calculating the allocator using total revenues rather than total expenses in the denominator would severely understate the common cost factor, because it would fail to capture cost of money and income tax requirements associated with assets attributable to marketing and services, common operations, and network operations general supervision. See B. Smith Reply Aff. ¶ 75.

Finally, Missouri's common cost factor of 16.47 percent is on the low end of states within SBC's region. See id. ¶¶ 77, 78. The Missouri PSC did not err in accepting SWBT's common cost factor.

Power, Engineering and the "ACES" Model. In order to convert the incremental investment derived from other network investment cost models into a monthly cost, SWBT uses the ACES cost model. Contrary to AT&T's suggestion, the model does not include embedded costs. See B. Smith Reply Aff. ¶ 78. Although SWBT uses historical data for current efficient technologies already in use in the network as a means of providing credible evidence with which to predict future costs for these same efficient technologies, the resulting costs developed from these data represent forward-looking costs. Id.

Current costs are used, therefore, only as a basis for estimating future costs. As Barbara Smith explains, SWBT developed factors by dividing current expenses by current investments for the most efficient technologies in the current network. It then applied these factors to total forward-looking investment to calculate forward-looking costs. Id. ¶ 79. Where the model made

certain embedded-cost assumptions – such as assuming, when calculating the replacement cost of buildings, that SWBT would build exactly the same number and size of buildings in the same locations – the Missouri PSC Staff recommended modifications to the way the factor was calculated to avoid overstating the investment in network and other buildings. See Costing and Pricing Report at 79-80. Nothing in this record remotely supports the argument that the Missouri PSC failed to apply TELRIC principles in evaluating SWBT's ACES model.

2. The Rates for Unbundled Loops Are TELRIC Based

AT&T, WorldCom, and the DOJ have variously identified a number of factors that they believe have inappropriately inflated the rates for unbundled loops. In their view, the Missouri PSC applied a fill factor that was too low, ignored the presence of integrated digital loop carriers, failed to assume the tapering of feeder cable, and misallocated dark fiber. They are wrong on all counts.

Distribution Fill. In the Kansas/Oklahoma Order, this Commission recognized the importance of setting an appropriate fill factor – “[i]f a fill factor is set too high, the particular element will have insufficient capacity to accommodate anticipated increases in demand or services outages. If a fill factor is set too low, the network could have considerable excess capacity, which results in increases to the per-unit cost higher than an efficient firm’s cost.” Kansas/Oklahoma Order ¶ 78. The Commission concluded that a distribution fill factor of 30 percent is “unreasonably low” and that a state commission errs when it uses “current fill, and refuse[s] to consider the forward-looking fill or assume that the fill factor would increase over time.” Id. ¶ 80.

After carefully examining SWBT's cost studies and assumptions regarding distribution fill, the Missouri PSC rejected SWBT's proposal to use its actual fill factors as “the best

representation of utilization in a rapidly changing competitive environment.” Costing and Pricing Report at 13. Instead, the Missouri PSC Staff recommended increasing the distribution fill factor to 40 percent. Although the Staff rejected SWBT's current fill, there is substantial evidence that distribution fill has remained remarkably constant over time and that it is not likely to increase significantly going forward. See B. Smith Reply Aff. ¶¶ 45-48.

Neither the DOJ nor the interexchange carriers even acknowledge that this is precisely the same fill factor that the Texas Public Utility Commission established and that this Commission effectively approved in granting Southwestern Bell's section 271 application in Texas. Moreover, contrary to the commenters' suggestion, this Commission did not reject a 40 percent fill factor in its recent Massachusetts Order.⁹ In the absence of any argument about how the Missouri PSC erred in selecting a distribution fill of 40 percent, there is no basis for rejecting the state commission's conclusion on this issue.

Integrated Digital Loop Carrier. AT&T asserts that the Missouri PSC inflated the loop rates by not assuming that all of the loops would be served through “more efficient and less costly” integrated digital loop carriers (“DLCs”). See AT&T Comments at 21. But as Barbara Smith explains, it is entirely unrealistic to assume 100 percent integrated digital loop carriers, because “[o]nly a non-integrated DLC and its associated equipment can enable individual unbundled loops to be terminated on the [main distributing frame] for cross connection to the CLEC. Unbundled loops cannot be extracted or ‘groomed’ from an IDLC system without significant additional expense.” B. Smith Reply Aff. ¶ 57. SWBT's cost studies reasonably assume the presence of facilities such as the Remote Terminal, the Central Office Terminal, the

⁹ Memorandum Opinion and Order, Application of Verizon New England Inc., et al., For Authorization to Provide In-Region, InterLATA Services in Massachusetts, CC Docket No. 01-9, FCC 01-130, ¶ 39 (rel. Apr. 16, 2001).

plug-in universal DLC circuit cards (as well as the cabinets and huts for all this equipment) that allow the unbundled loops to be terminated on a non-integrated basis. Id. ¶ 58.

In ordering SWBT to assume that 25 percent of its network would be served through integrated DLCs, the Missouri PSC lowered the loop costs without permitting SWBT to recover the additional costs for direct labor and engineering that would be required to provision an unbundled loop using an integrated configuration. Id. ¶ 59. Rather than overstating forward-looking costs for the loop, the Missouri PSC's assumption of integrated DLC probably understated such costs.

Tapering of Feeder Cable. AT&T argues that the Missouri PSC failed to allow for the tapering of feeder cable. See AT&T Comments at 22. This allegedly has the effect of incorrectly assuming a larger number of smaller cables (with a higher cost per pair) as opposed to a larger sized cable at the beginning of the feeder segment that tapers into smaller cables, each of which terminates into a multiple number of feeder distribution interfaces ("FDIs"). See Costing and Pricing Report at 18-19.

Both AT&T and the Missouri PSC Staff apparently misunderstood that SWBT's cost studies already account for cable tapering by weighing the different sizes of cable to develop an average pair foot investment for the loop study. See B. Smith Reply Aff. ¶ 40. All of the cable sizes and their corresponding lengths from the company inventory of cable are used in the calculation of the average pair foot investment for the total cable including feeder and distribution. Id. The feeder portion is determined through an inventory of the FDIs; the residual is assigned to the distribution portion. Because SWBT's cost studies take the entire inventory of cable sizes as a starting point to determine the average cost per pair foot for the entire cable, any feeder cable sizes that are not included because of the assumption that each feeder segment

terminates in only one FDI would then become part of the distribution cable. Although this methodology may slightly overstate the cost of the feeder cable, it slightly understates the costs of the distribution cable. Id. Contrary to AT&T's assertion, therefore, the cost study takes into consideration the tapering of feeder cable.

Allocation of Dark Fiber. AT&T's final argument with respect to the loop rates is that SWBT's cost studies improperly permit SWBT to recover the costs of dark fiber in its UNE loop rates when the fiber fill factor already allows SWBT to recover conduit investment associated with unused fiber. See AT&T Comments at 23. AT&T fails to acknowledge, however, that the Missouri PSC Staff significantly modified SWBT's fill factor for dark fiber in order to take this precise issue into account. See Costing and Pricing Report at 77-78. SWBT had proposed a fiber fill factor of 60 percent, but the Missouri PSC Staff increased the fill factor to 95 percent. Id. at 78 ("This would allow SWBT to retain 5 percent of its fibers for breakage.").

With respect to conduit investment, the Missouri PSC Staff expressly rejected the suggestion that SWBT might be double recovering its dark fiber investment. Although building the fiber fill factor into the conduit factor "would raise some concerns since the unused fiber is dark fiber and the investment associated with dark fiber can be recovered separately," id. at 18, the Missouri PSC Staff addressed such concerns: "[a] review of the dark fiber cost studies indicated that no conduit costs are being recovered through dark fiber so the issue of double recovery does not apply," id.; see also B. Smith Reply Aff. ¶¶ 60-61.

3. The Switching Rates Are TELRIC Based

AT&T, WorldCom, and the DOJ have all raised concerns about the Missouri switching rates. They claim that the Missouri PSC did not adequately take into account discounts on initial purchases of switches, relying instead on lower discounts applicable to growth jobs. And they

also argue that the Missouri PSC improperly permitted SWBT to apply a hardware factor for additional switch investments. Neither of these arguments is persuasive.

Switch Discounts. SWBT's Switching Cost Information System ("SCIS") model develops switch discounts using a weighted mix of switch discounts for initial placements of switching equipment and growth jobs to add new line equipment. See B. Smith Reply Aff. ¶ 22. The prices and discounts were determined by examining SWBT's procurement contracts with its switch vendors, and SWBT developed a weighted average discount for each vendor by reviewing contract information. Id. The Missouri PSC closely reviewed the SCIS model, making several modifications based on its belief that "SWBT is receiving discounts in addition to those used in SWBT's original cost studies." Costing and Pricing Report at 32. The Staff reviewed vendor contracts, Firm Price Quotes, and purchase orders, leading to different discounts on Nortel and Lucent switches. Id. The result of Staff's modifications was that the discount applicable to Lucent switches more than doubled and the Nortel discount increased by 28 percent. See B. Smith Reply Aff. ¶ 23.

AT&T also argues that the SWBT cost studies failed to account for discounts that SWBT received on engineering and installation costs. See AT&T Comments at 24. But, in contrast to AT&T's argument, the Missouri PSC Staff never concluded that these discounts should have been included in the cost studies. Instead, it merely concluded that it "could not confirm whether or not SWBT receives discounts on engineering and installation." Costing and Pricing Report at 32. In fact, SWBT's contracts at the time with Nortel and Lucent did not include discounts for engineering and installation, so the Missouri PSC Staff's concerns were for naught. See B. Smith Reply Aff. ¶ 26.

In the New York Order, this Commission considered and rejected a virtually identical argument by AT&T to the New York Public Service Commission's treatment of switch discounts. See Memorandum Opinion and Order, Application by Bell Atlantic New York for Authorization Under Section 271 of the Communications Act To Provide In-Region, InterLATA Service in the State of New York, 15 FCC Rcd 3953, 4083-86, ¶¶ 242-247 (1999). Bell Atlantic had proposed a cost per line of \$586, compared to AT&T's proposal of \$125 per line. "The New York Commission then conducted its own examination into switching costs, after which it estimated a per-line switch cost of \$303, which it reduced to \$192 to account for declining switch prices within the industry." Id. at 4083-84, ¶ 242. This Commission concluded, based on the evidence in the record, that "the New York Commission has already considered AT&T's allegation that Bell Atlantic's proposed switch costs were too high and responded appropriately. Bell Atlantic may only recover \$192 per switch per line, a significant reduction from its original proposal of \$586 per line and an amount much closer to AT&T's estimation." Id. On review, the D.C. Circuit expressly concluded that this decision was reasonable. AT&T v. FCC, 220 F.3d 607, 617 (D.C. Cir. 2000).

Just as in New York, the Missouri PSC made adjustments to SWBT's original SCIS studies to account for lower switch prices. SWBT's original studies yielded a price per line of ** ***. After the Commission ordered the adjustments to the local switching study, the price per line came down to ** *. At that time, AT&T had proposed a price per line of \$115 in Texas. (Because of the procedures adopted by the Missouri PSC in reviewing the parties' cost studies, SWBT never learned AT&T's proposed switching price per line in Missouri). Like the New York Commission, the Missouri PSC ordered a switching rate that was far closer to AT&T's proposal than it was to SWBT's. See B. Smith Reply Aff. ¶ 23.

Indeed, the record in New York revealed that while the New York Commission reduced the switching cost per line in light of “declining switch prices within the industry,” 15 FCC Rcd at 4084, ¶ 242, the New York Commission had not, in fact, incorporated any switch discounts on purchases of new switches. See AT&T v. FCC, 220 F.3d at 617. In marked contrast to the Missouri PSC – which expressly incorporated substantial switch discounts into its final switching rates – the New York Commission declined to do so at all, reasoning that “switching costs in general represent a much smaller component of CLEC expense than do the much more significant [loop] costs.” Id. (quoting Order Denying Motion to Reopen Phase 1 and Instituting New Proceeding at 12 (N.Y. PSC Sept. 30, 1998)). Nevertheless, both this Commission and the D.C. Circuit on review concluded that the New York Commission’s decision not to incorporate any switch discounts was reasonable. In light of the New York Order, it is difficult to see how a state commission such as the Missouri PSC that applies substantial switch discounts – albeit smaller discounts than AT&T desired – could be acting unreasonably.

Moreover, this Commission expressly concluded that it was “not persuaded by AT&T’s assertion that in our Universal Service proceeding, we disallowed the cost recovery of ‘augmented switches,’ and that Bell Atlantic’s recovery includes such cost recovery, which violates our rules.” New York Order, 15 FCC Rcd at 4085, ¶ 245. The Commission reiterated its position that the federal Universal Service cost model was developed for purposes of determining federal universal service support and that it may not be appropriate to use nationwide values for other purposes, “such as determining prices for unbundled network elements.” Id. (quoting Tenth Report and Order, Federal-State Joint Board on Universal Service, 14 FCC Rcd 20156, 20172, ¶ 32 (1999)). AT&T, WorldCom, and the DOJ have

consistently refused to heed this Commission's express warning against "making any claims in any other proceedings based on the inputs adopted in the Universal Service Tenth Report and Order." Id.

Feature Related Hardware. SWBT's local switching cost study identifies the TELRIC costs per minute of use for local switching. The study uses such inputs as switching investment, hardware investment, and minutes of use in order to convert investments into costs using the ACES model. Feature related hardware consists of hardware components needed to provide features that are not part of the office reports used by the SCIS model to develop the total investment for local switching. The Missouri PSC Staff carefully reviewed SWBT's feature related hardware factor and made several significant adjustments to it. For example, it required SWBT to apply the factor only to DMS-100 and 5ESS switches, because the hardware data used to develop the factor had been gathered only from these switches; because neither DMS-10 or Ericsson AXE-10 switches had been used for data gathering, the Missouri PSC concluded that the factor could not be applied to investments in those switches. Costing and Pricing Report at 43.

The Missouri PSC Staff identified one category of equipment – "input/output port for simplified message desk interface" – as a potential issue, because the Staff did not know what types of ports are included in this category. Id. AT&T misleadingly suggests that the Missouri PSC Staff had somehow found that SWBT had overstated the feature hardware investment. See AT&T Comments at 24-25. In reality, of course, the Staff merely raised the question whether certain investments might be double counted. In fact, there is no double recovery. The maintenance input/output ports are not included in another investment category in the SCIS

study, so it was entirely appropriate that they be included in the hardware investment total. See B. Smith Reply Aff. ¶ 33.

4. The Nonrecurring Charges Are Reasonable and Cost Based

Nonrecurring charges are intended to recover the one-time labor and expensed material costs associated with provisioning unbundled network elements. In Missouri, as in each state in its region, SWBT carried out cost studies for calculating nonrecurring costs by identifying work groups involved in particular tasks; identifying the time required to perform each function and the labor rate associated with the employee performing the function; multiplying the labor rate by the labor time to determine the cost for performing the function; and grouping the work functions by cost element and totaling them to establish a forward-looking nonrecurring cost per element. See B. Smith Aff. ¶ 33.

After carefully reviewing these studies, the Missouri PSC Staff concluded that certain substantial downward adjustments were appropriate. See Costing and Pricing Report at 121-24. Indeed, the Missouri PSC ultimately accepted staff's recommendation to set the rates for nonrecurring charges at 50 percent of the cost-based rates proposed by SWBT. The M2A, of course, incorporates a UNE pricing appendix that reflects a further 25 percent reduction in nonrecurring charges (subject to the T2A floor).

It is particularly disingenuous of AT&T to challenge the nonrecurring rates in Missouri. Although SWBT had challenged the 50 percent reduction in nonrecurring charges as unjustified and arbitrary, AT&T never challenged the resulting rates as inconsistent with forward-looking cost principles. On the contrary, in its brief to the District Court for the Western District of Missouri, AT&T defended the very rates it is now attacking here: "Given the significant discrepancies between AT&T and SWBT as to the efficient amount of time required to perform

NRC functions, Staff's recommendation to reduce NRCs by 50 percent from SWBT's proposals, which was subsequently adopted by the PSC, far from being arbitrary and capricious, constitutes a reasonable policy determination supported by the administrative record." AT&T's Opposition to SWBT's Motion for Summary Judgment at 25, AT&T Communications of the Southwest, Inc. v. Southwestern Bell Tel. Co., Case No. 97-1573-CV-W-5 (W.D. Mo. filed Nov. 16, 1998) (emphasis added).¹⁰ Moreover, on appeal to the Eighth Circuit, AT&T reiterated its defense of the nonrecurring charges: "far from adopting a random compromise, the PSC reasonably adopted the Staff's conclusions, which were based on a conscientious effort to determine accurate NRCs on the basis of the best evidence available in the record." Brief for Defendant-Appellee AT&T Communications of the Southwest, Inc. at 50, Southwestern Bell Tel. Co. v. Missouri Pub. Serv. Comm'n, Nos. 99-3833 & 99-3908 (8th Cir. filed Feb. 14, 2000) (emphasis added); see also id. at 51 ("The PSC properly . . . reduced [SWBT's proposals] to more appropriate levels according to the best evidence available in the record.").¹¹

Barbara Smith explains in her reply affidavit that differences in the nonrecurring charges among Texas, Kansas, and Missouri are attributable to differences in the way each state commission estimated forward-looking costs associated with time and labor rates. See B. Smith Reply Aff. ¶¶ 48-50. In predicting how much such costs would decline over time, it is hardly surprising that each state commission made different assumptions and arrived at different final rates. Id. ¶ 50. In Kansas and Texas, the state commissions ordered specific reductions in the labor rates, while making other downward adjustments that they never explained. Id. ¶ 49. In Missouri, when faced with uncertainty and incomplete data, the Missouri PSC did the best it

¹⁰ See Hughes Reply Aff. Attach. A.

¹¹ Hughes Reply Aff. Attach. B.

could. That it ultimately arrived at higher nonrecurring charges for some elements (as well as lower charges for others) than those established by other state commissions is to be expected.

5. The Interim Rates Established in Case No. TO-98-115 Are Lawful

As Southwestern Bell explained in its opening brief, the M2A offers, on an interim basis subject to true-up, all of the prices for UNEs and services that were ordered by the Missouri PSC in the Second Arbitration Order as part of Case No. TO-98-115. See Southwestern Bell Br. at 29. This Commission has made clear that “the mere presence of interim rates will not generally threaten a section 271 application so long as an interim solution to a particular rate dispute is reasonable under the circumstances, the state commission has demonstrated its commitment to our pricing rules, and provision is made for refunds or true-ups once permanent rates are set.” Texas Order, 15 FCC Rcd at 18394, ¶ 88. Although the DOJ and others complain about the fact that these rates are interim, they neglect to mention that a great number of them have been set at zero. In fact, 102 out of the 136 interim rates from Case No. TO-98-115 are set at zero even though the Missouri PSC recognized that SWBT incurred real costs. See Hughes Reply Aff. ¶ 29.

Clearly, the CLECs have benefited from the fact that these interim rates have been in place so long. Indeed, when SWBT proposed an expedited procedural schedule in the docket to replace these interim rates with permanent rates, the CLECs opposed it. Instead, they convinced the Missouri PSC to adopt a schedule that would postpone any hearing until the end of this calendar year. See id. ¶ 31. The CLECs are clearly not in any hurry to replace these interim rates, for SWBT will bear the financial risk from providing zero-based interim rates beyond the six-month true up period. Id.

B. The UNE Rates Are Not To Blame For CLECs' Lack of Commitment to Facilities-Based Competition

A number of commenters argue that the lack of substantial local competition in Missouri constitutes evidence that the UNE rates are not TELRIC-based. See, e.g., AT&T Comments at 61 & n.62; El Paso/PacWest Joint Comments at 28-29; Z-Tel Comments at 8. This Commission has expressly rejected that argument: “[W]e do not accept [the] assertion that competitors lack a sufficient profit margin between Verizon’s retail and wholesale rates to allow local residential competition over the UNE-P, which indicates that the UNE rates are not TELRIC based.”

Massachusetts Order ¶ 41. As the Commission went on to explain, “efficient entry” simply means that “competitors seeking entry will face the same sorts of costs they would face in a fully competitive market, that is, TELRIC-based UNE rates. . . . Contrary to AT&T’s assertion, the concept of ‘efficient entry’ does not guarantee that any competitors will necessarily enter the market. Even if competitors can gain ‘efficient entry’ to a market through the availability of TELRIC-based UNE-rates, they may still decide not to enter based on their independent determinations that they cannot turn a sufficient profit in the market.” Id. ¶ 42.

Whatever the reasons that competitors have chosen not to enter the local market in Missouri through the UNE Platform, the evidence is clear that Missouri’s UNE-P rates are not at fault. A comparison of Missouri rates with those of states in which section 271 relief has been granted reveals that the average Missouri UNE-P monthly rate is less than a dollar above Oklahoma’s Alternative Regulation Plan reviewed by the FCC, and only \$0.08 above the O2A rates. See Sparks Reply Aff. ¶ 29 & n.17.

Most significant, however, is the fact that Missouri’s UNE-P rates are considerably lower than those in New York and Massachusetts – the New York rates are 4.7 percent higher and the Massachusetts rates are 12.7 percent higher. Id. ¶ 29. Yet, as of April 2001, CLECs had

purchased 1.7 million unbundled element platforms from Verizon in New York.¹² There are surely many reasons why CLECs might prefer to enter the local markets in New York over those in Missouri, but it is simply incredible for AT&T, WorldCom, and others to claim that the rates are the reason.

Indeed, within the past two weeks, the former Chairman of this Commission and the current Chairman of the Texas Commission testified before Congress that the principal reason for the lack of residential competition is not that wholesale rates are too high but rather retail rates are too low. According to Former Chairman Reed Hundt, “[i]n terms of residential, voice, telephone service . . . about 40 percent of all consumers are paying less than the cost to provide a service. . . . And there’s no way that someone else is building an overlapping network to repeat the experience of offering a below-cost service.”¹³ And Texas Commission Chairman Pat Wood agreed:

Residential rates are low. . . . They may even be lower than cost. . . . It will be difficult for competitors to ever come into the Texas market – just as it would be difficult to get into the California electricity market – if you can’t sell for the proper price or compete with the proper price what you just bought for \$10 more. . . . [I]t’s important to know that residential rates were purposely subsidized for 80 years. And business rates and long-distance rates are kept high to make up for that.¹⁴

¹² See Declaration of Paul A. Lacouture and Virginia P. Ruesterholz ¶ 90, Application by Verizon New York Inc., et al., for Authorization To Provide In-Region, InterLATA Services in Connecticut, CC Docket No. 01-100 (FCC filed Apr. 23, 2001).

¹³ Reed Hundt, Former Chairman, Federal Communications Commission, The Telecom Act Five Years Later. Is it Promoting Competition?, Panel Discussion to Hearing of the Senate Antitrust, Business Rights and Competition Subcommittee of the Judiciary Committee (May 2, 2001) (emphasis added).

¹⁴ Pat Wood, Chairman, Texas Public Utilities Commission, The Telecom Act Five Years Later. Is it Promoting Competition?, Panel Discussion to Hearing of the Senate Antitrust, Business Rights and Competition Subcommittee of the Judiciary Committee (May 2, 2001).

AT&T purports to find support for its argument that SWBT is somehow responsible for the recent sluggishness in the growth of local competition by selectively and misleadingly quoting from the Texas Commission's Report on Scope of Competitions in Telecommunications Markets of Texas (Jan. 2001) ("Texas Commission Report") (attached to AT&T Comments at Tab 1). See AT&T Comments at 54-55, 64-70. According to that Report, "cross-subsidies that have traditionally kept residential rates artificially low now contribute to the lack of competition for residential customers. The same cross-subsidies have provided cream-skimming opportunities in large metro and business markets." Texas Commission Report at x. Rather than blaming SWBT, the Texas Commission recognized that the primary reason that competition looks less viable for certain rural and residential customers than in the business and urban markets, is "rooted in underlying market conditions and in the historical regulatory pricing system for local telephone service." Id. at 85. The continuation of Texas' long-standing public policy to provide universal service and to maintain low rates for basic residential local service "means that some segments of the market may not receive rates that reflect the true cost of the service. . . . Most residential and rural customers receive basic local services at rates well below their true cost (with the remainder of the cost subsidized by Texas and federal universal service payments and over-priced vertical or nonbasic services)." Id. at xi.

Nevertheless, the Texas Commission Report also recognizes that local competition is thriving in certain markets: "The Large Metropolitan areas and the Suburban counties, which combined comprise almost 60 percent of Texas' population, have heavy concentrations of CLECs. Data show that the Dallas and Houston metro areas have about twenty or more CLECs serving customers, while San Antonio and Austin have ten or more CLECs serving customers. Many rural areas that allow for customer choice have a choice of two, three, or more CLECs, in

addition to an ILEC.” Id. at 78. And the market for “business customers in the Large Metro areas of Texas appears to be competitive. Facilities-based competition has provided increased capacity for CLECs to compete with ILECs over the long term.” Id. at 83.

The Texas Commission Report recognizes that the softening of the economy is principally responsible for the recent difficulties experienced by many CLECs. “[I]nvestor sentiment turned sharply negative towards the telecommunications sector when CLECs were unable to convince investors that prevailing and projected profits were large enough to justify the prevailing level of investment and high share prices.” Id. at 56. AT&T, itself, was not immune from these forces, and the Texas Commission Report recognizes that these economic developments have required AT&T to withdraw from its “ambitious but unprofitable business plan,” id. at 58.

Try as AT&T might to blame SWBT for its own financial difficulties – as well as for those of other CLECs – the truth is that the problems experienced by CLECs nationwide are either of their own making or linked to particular vulnerabilities in the recent economic downturn. Since March 2000, the NASDAQ index has fallen more than 50 percent; CLEC shares have fallen more than 75 percent; and data CLEC shares have fallen more than 90 percent. The bursting of the technology bubble has reduced the ability of CLECs to obtain venture capital because their business models failed to show any likelihood of profits in the foreseeable future. Most of these CLECs adopted business models that depended entirely on their ability to raise such capital for their continued viability.¹⁵

¹⁵ See Supplemental Reply Declaration of Dr. William E. Taylor ¶ 25, Application by Verizon New England Inc., et al., for Authorization To Provide In-Region, InterLATA Services in Massachusetts, CC Docket No. 01-9 (FCC filed Feb. 28, 2001).

To their credit, most CLECs have refused to follow AT&T's example of holding SWBT and other incumbent LECs responsible for their financial difficulties. As NorthPoint's CEO, Elizabeth Fetter, put it, "We were highly incented by Wall Street to spend money like drunken sailors," leaving CLECs ill-prepared for a financial downturn.¹⁶ And because similar financial difficulties are affecting CLECs' main customers – Internet service providers ("ISPs") – many of them are simply not paying their bills, and this has become a major contributing factor to the financial difficulties of the CLECs themselves.¹⁷ "Delinquent and 'at-risk' ISPs account for 58 percent of [Covad's] total lines."¹⁸ As one industry analyst has noted, "Having too many ISP partners resell DSL may have been one of the key mistakes of the data competitive local exchange carriers (CLECs). . . . 'They didn't have stringent enough requirements for the financial health of their business partners.'"¹⁹

¹⁶ Scott Woolley, Highway to Hell, Forbes, Feb. 19, 2001, at 98. As the CEO and a founder of the data CLEC Jato Communications, Brian Gast, has noted, "in hindsight, (there were) a lot of naïve assumptions that capital would always be there to fund the business plan." Kris Hudson, Jato's Fall Reflects Industry Problems, Denver Post, Dec. 30, 2000, at C-01. As a spokesman for one CLEC, Votts Networks, has explained, companies tried for "success by growth, instead of growing by success. Some of these guys overbuilt and got way out ahead of their funding." Peter J. Howe, DSL Start-Ups Begin To Fold Before Turning a Profit, While Bells Sit Pretty, Boston Globe, Dec. 17, 2000, at F1. Covad's Chairman, Chuck McMinn, observed, "There has been a dramatic shift in focus that has occurred in our industry, turning us from growth to profitability as the metric." Jessica Johnson, DSL Forecast: Foggy, But Clear Road Beckons (Jan. 4, 2001), at <http://www.clec.com>. HarvardNet's President, Mark Washburn, likewise announced that "[t]he markets have gone from a position of, 'What will you do for me next year?' to 'What will you do for me this quarter?'" Peter J. Howe, DSL Providers Fail Without Deep Pockets, The Deseret News, Dec. 20, 2000, at C-03.

¹⁷ Covad Restructuring More Drastic Than Expected, *Journal Reports* (Feb. 21, 2001), at <http://www.clec.com>.

¹⁸ J. Camp, et al., Morgan Stanley, Dean Witter, Investext Company Report No. 2394704, Covad Communications Group (Dec. 14, 2000).

¹⁹ Vincent Ryan, Headed for a Fall?, Telephony, Dec. 18, 2000 (quoting Patrick Hurley, DSL analyst at TeleChoice).